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DRUG MONEY LAUNDERING, BANKS AND FOREIGN POLICY

September 27, October 4, and November 1, 1989

A REPORT

TO THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

BY THE

SUBCOMMITTEE ON NARCOTICS, TERRORISM AND INTERNATIONAL OPERATIONS

FEBRUARY 1990

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LETTER OF TRANSMITTAL

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington DC., June 15, 1990.

Hon. CLAIRBORNE PELL,
Chairman, Committee on Foreign Relations,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: In 1987 and 1988, the Subcommittee on Terrorism, Narcotics, and International Operations of the Foreign Relations Committee began to investigate the relationship between narcotics trafficking, law enforcement, and foreign policy. Last year, the subcommittee further explored the implications of drug trafficking world-wide by focusing on international money laundering. This report, "Drug Money Laundering, Banks, and Foreign Policy," is a report by the Chairman of the subcommittee to the full committee and is based on oversight hearings before the Senate Foreign Relations Committee on September 27 and October 4, 1990 and hearings before the Senate Banking Committee on November 1, 1990.

The subcommittee reviewed testimony from U.S. law enforcement agencies, the banking industry including regulators and representatives of financial institutions as well various other authorities. Witnesses included the Deputy Director of the DEA and the Chief of Financial Intelligence for the DEA, the Assistant Commissioner of the U.S Customs Service, the Assistant Commissioner of the IRS, the Assistant Secretary for Financial Enforcement at the Treasury Department, and the Chairman of the White Collar Crime Commission. The subcommittee also reviewed testimony from officials from the Independent Bankers Association of America and the American Bankers Association, the New York Clearinghouse for International Payments System, the State Comptroller's offices in New York and Florida as well as the President of the National Check Cashers Association.

This review of the hearing record has demonstrated that international money laundering is simultaneously a foreign policy issue as well as a domestic problem which must be addressed by the Federal Government and the international banking community. On the basis of the conclusions reached as a result of the hearings, the subcommittee has included specific recommendations for legislation in section HI of this report.

I very much appreciate the support and assistance you have given us through the course of this inquiry. I would like to note my personal appreciation for the efforts of David McKean and Jim Brenner, both of my staff, who assisted me with the hearings and

helped prepare the enclosed report. Jonathan Winer, also of my staff, and Robin Cleveland of Senator McConnell's staff provided additional assistance.

I believe this review has further documented the magnitude and complexity of the drug money laundering business. I hope this report will contribute to a better understanding by the Congress of the nature of the problem, and that it will stimulate constructive debate on this vitally important issue.

Sincerely,

JOHN KERRY,
Chairman, Subcommittee on Terrorism, Narcotics and International Operations.

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FINDINGS

(1) The laundering of illegal drug profits is a $300 billion annual business directly involving those at the top of the drug trafficking hierarchy. Because money laundering is principally accomplished through the use of financial institutions, subject to Government audit and supervision, money laundering is the potential Achilles heel of the illegal drug business.

(2) The Cash Transaction Reports (CTR) process mandated by the Bank Secrecy Act of 1970 is working as a deterrent to money laundering through financial institutions in the United States. Nevertheless, adequate resources have not been devoted to enforcement of these provisions and money launderers have circumvented the full impact of these controls. In addition, because of weak or nonexistent foreign regulation, drug trafficking organizations continue to use foreign banks and foreign branches of U.S. banks to launder U.S. drug profits.

(3) Switzerland, Canada, the Bahamas, Luxembourg, Panama, and Hong Kong are among the jurisdictions most commonly used to launder drug money from the United States. A number of small countries with relatively limited economies have also developed into significant money laundering centers, including Andorra, Anguilla, Antigua, the Cayman Islands, the Channel Islands, Gibraltar, Liberia, The United Arab Emirates, Liechtenstein, Montserrat, Nauru, the Netherlands Antilles, the Turks and Caicos Islands, and Vanuatu.

(4) There is currently little, formal ongoing cooperation between the banking community and the enforcement community. Bankers are not always clear about what law enforcement authorities are looking for in the realm of suspicious transactions and conversely, law enforcement officials lack the necessary training in banking issues that would improve investigations.

(5) There continue to be failures of coordination among Federal agencies working on antimoney efforts and among Federal agencies and State agencies.

(6) Organized crime organizations participated in the theft of S&L assets that has taken place in the United States. Significant funds generated from S&L theft have been laundered beyond U.S. borders through offshore bank secrecy havens. These funds now represent an enormous tax exempt endowment devoted to the support of organized crime.

(7) As American banks have become subject to greater regulation, money launderers have turned to nonfinancial institutions and to unregulated financial institutions such as money transmitters, check-cashing stores, and currency exchanges. The Treasury Department has failed to develop a plan or commit the resources necessary to combat this problem, despite the existence of broad

statutory authority contained in the Money Laundering Control Act.

(8) There is currently no world standard for the kind of information required to conduct an international wire transfer. There is also no U.S. policy to require that electronic transfers of U.S. dollars be executed only through regulated, audited entities. As a consequence, money launderers retain a choice of methods to conceal their laundered funds through international wire transfers, including informal channels involving fax machines, telex, personal computer networks, and ordinary telephone instructions which do not leave the paper trail which would allow investigators to follow the flow of funds.

(9) A substantial factor in the use of financial institutions to launder drug money has been the failure of those " institutions to implement procedures adequate to ensure they "know the customer."

(10) The recent plea bargain agreement in the Government's money laundering case against the International Bank of Credit and Commerce in Tampa, FL, represents a noteworthy failure on the part of the Justice Department. Not only did the Government fail to levy penalties commensurate with the crimes of the bank, it agreed to forfeit its right to further investigate and prosecute potential serious allegations about the bank's practices, organization, and structure.

BACKGROUND

In 1988 the chairman and the ranking Republican of the Foreign Relations Subcommittee on International Terrorism and Narcotics, Senators John Kerry and Mitch McConnell, initiated an extensive review of the links between narcotics trafficking, money laundering, and the international banking system. This review is an outgrowth of an earlier subcommittee investigation between 1986 and 1988 into international narcotics trafficking in Central and South America.

The goals of the current review are twofold: first, the subcommittee seeks to exercise its responsibility for oversight of various executive branch agencies with respect to the international war on drugs, and money laundering in particular. The second purpose of the subcommittee's inquiry is to identify areas where new legislation may be necessary.

Money Laundering Defined

Money laundering is the conversion of profits of illegal activities into financial assets which appear to have legitimate origins. As a result of the hearings between 1986 and 1988, the subcommittee concluded that a direct attack on the money laundering activities of the international drug cartels may be one of the most effective tactics in the war on drugs.

Since the subcommittee began its investigation in 1986 this view has come to be widely shared. For example, the Assistant Secretary for Financial Enforcement at the Treasury Department, Salvatore Martoche, in October 1989 told the Foreign Relations Committee that "the kingpins put a great deal of distance between themselves and their product, but very little distance between themselves and their money." And Senator Riegle, chairman of the Senate Banking Committee, stated before the Banking Committee in November: "[the drug business] is a money business. And if you interrupt the flow of money, you've seriously damaged the business."

Because drug traffickers deal exclusively in cash, the ability to launder their profits is essential. Money laundering, however, is not limited to drug criminals: it is an important component of any criminal enterprise that generates cash. As Senator Bond pointed out in hearings before the Senate Banking Committee, "money laundering is not just associated with the Medellin cartel. All types of organized crime need to conceal the sources of their illegal profits."

The Size of the Problem

Assistant Treasury Secretary Martoche estimates that annual worldwide drug revenues are $300 billion, including $110 billion generated in the United States. Martoche further estimates that 20

percent of the revenues represent the cost of the drugs sold, with the remaining 80 percent representing pure profit for the traffickers.

Laundering this much money poses significant problems for the traffickers. For example, $100 billion in $20 bills (the most commonly used currency denomination of a drug transaction), weighs approximately 26 million pounds. A money laundering operation in New York shut down earlier this year required a tractor-trailer to haul away $19 million in small bills.

Of course, not all of the cash revenue collected by drug traffickers must be laundered. A portion of the funds can be used to pay the expenses of the cartels. As DEA Deputy Terry Burke explained, "part of the money that is generated here in the United States has to go back to support and repay the producers of the coca leaf * * * the transportation system, and the people who processed it. Some of the money goes back to the traffickers for ready money, if you would, for their own pleasures. Much of it, though, they have learned to put through the banking system, a laundry system, so that they can use that money to increase their power base."

In testimony before the subcommittee in September 1989, Special Agent David Wilson, the DEA's expert on financial intelligence, described the laundering process as follows: "The Colombian cartels provide drugs to their wholesale distributors which in turn supply the retail distribution network. The money flows from the neighborhoods where drugs are sold back to central collection points—generally in large cities. The cartels employ specialized money couriers or collectors who are outside the drug distribution network. These individuals collect, sort, count, and package the money for shipment."

The bulk currency is then typically handled in two different fashions. In the first case the cash is deposited in legitimate U.S. banking institutions either through the guise of a shell company created to give the impression that it generates large amounts of cash, or it is deposited into the banking system with the cooperation of corrupt employees. Cash can also be deposited without triggering a CTR by "smurfing" or "structuring" the transactions to keep them below the $10,000 threshold. This approach, however, imposes large transaction costs upon the launderer as well as a high probability of detection by alert bankers. Since 1986, Federal law has made money laundering a crime, and as a result these activities are increasingly risky.

As U.S. law enforcement agencies, financial regulators, and institutions have become more aware of money laundering techniques and as U.S. law has gradually increased the penalties for money laundering, drug traffickers—particularly the wholesale distributors and smugglers—have discovered an easier way to deal with their caches of cash: by smuggling it out of the United States. As Agent Wilson explained "the bulk of the currency being collected by the drug cartels is being smuggled offshore."

The Stages of Money Laundering

Although many different techniques and methods are used to launder money through financial institutions both here and

abroad, Assistant Commissioner William Rosenblatt of the U.S. Customs Service provided the subcommittee with a generic model to describe various stages or "wash cycles." Based on this model, money laundering consists of three distinct stages: placement, layering, and integration. Placement is the physical disposal of bulk cash, either by commingling the cash with the proceeds of a legitimate business, or otherwise converting currency into deposits on the books of a bank, securities firm, or similar financial intermediary. Layering is the process of transferring the funds among various accounts through a series of complex transactions designed to disguise the trail of illicit proceeds. The final stage, integration is the process of shifting the laundered funds to legitimate organizations with no apparent links to organized crime. Once integrated, the funds can be managed by sophisticated investment managers where they will remain available until required by their criminal owners.

There is a general consensus among law enforcement agencies and bankers that the greatest vulnerability of the money launderers is in the placement stage. The U.S. Customs Service in 1989 seized almost $200 million in illegal drug proceeds, predominantly at border crossing locations and airports. Assistant Commissioner Rosenblatt believes that aggressively pursuing money laundering at the placement stage will eventually yield not just millions, but billions in assets belonging to the drug cartels.

Despite the sophistication of the layering efforts of the drug cartels, law enforcement authorities have also had success in seizing drug traffickers assets after the placement stage. For instance, the Justice Department recently froze over $60 million in assets belonging to the late Gacha Rodriquez, one of Colombia's most notorious drug lords. Gacha's funds had already been successfully laundered, but law enforcement authorities, acting on documents seized in a raid in Colombia, were able to identify and freeze various accounts around the world in which Gacha had deposited his funds.

CASH TRANSACTION REPORTING (CTR) SYSTEM

Money laundering is designed to erase the paper trail that normally exists in the banking industry. In response to the abuses of the system, the U.S. Congress passed the Bank Secrecy Act (BSA) in 1970. Although there are many facets to the act, its essential feature is the requirement that all financial institutions must submit a currency transaction report for all cash transactions in excess of $10,000.

Early enforcement of the BSA was sporadic, and compliance levels were low. As late as 1983 banks were filing a total of 500,000 CTR forms a year. However, in 1985 several large regional banks were levied large fines for failing to properly file CTR's, and shortly thereafter compliance with the act sharply increased. This year, it is projected that banks will file in excess of 8 million CTR forms.

As the volume of forms filed increases, there is a growing debate over the usefulness of this process to deter money laundering. On the one hand, the Treasury Department argues that the CTR process is bearing fruit. Assistant Secretary Martoche, in testimony before the Foreign Relations Committee, argued that CTR's have been extremely useful in developing new leads. He noted that in the last 2 years over 700 targets have been identified and that many of the cases are ongoing. Assistant Commissioner William Rosenblatt of the Customs Agency claims that as a result of the artificial intelligence used by the Customs Agency, over 60 percent of the leads developed result in cases.

Assistant Commissioner Rosenblatt further testified that 35 to 40 analysts consistently interrogate this artificial intelligence during the 30-day period in which the forms are submitted. Secretary Martoche admitted, however, that the CTR process would be improved if banks were required to file CTR's on magnetic media, and he indicated that the Treasury Department would be issuing a proposed rulemaking on this issue for large volume institutions. Standardizing the CTR by requiring filing by magnetic media, it is believed, would make the processing and analysis of CTR's by both banks and Government investigators more efficient, and would allow the use of widely available personal computer technology. As Martoche put it in testimony before the subcommittee, "floppy diskettes is our motto."

In summary, the Assistant Commissioner of the IRS, Brian Bruh concluded that processing the forms within a 30-day period is not considered a backlog, and Assistant Secretary Martoche asserted that "Treasury is not overwhelmed" by the CTR process.

the Subcommittee on Terrorism, Narcotics and International Operations is skeptical of the Treasury's Department's assertions that there is adequate compliance, analysis, followup, and enforcement of the CTR process. These concerns are based on the testimony of

prominent members of the banking community as well as others in the law enforcement community.

The banking industry by and large recognizes the usefulness of the CTR process. Earl Hadlow of the ABA and Barnett Banks in Florida claims that the CTR process has "made it very difficult to illicitly get cash into the American banking system." He warns, however, that "the Government is literally being drowned in this sea of reports to the point * * * they might not be making effective use of the data they are getting."

Don Sargent of the Independent Bankers Association of America added anecdotal evidence to Hadlow's warning. Sargent related two instances where banks had alerted Federal authorities of suspicious CTR filings. According to Sargent, "In both cases, not only did the bank file the appropriate forms but the Treasury Department was alerted of these suspicious activities by telephone. An inspector did investigate, scanned the bank records, asked a few questions, but in neither case was the activity curtailed." Sargent added, "They have complained that in calling attention to particular suspicious cases of money laundering, their efforts have been totally ignored by the Government."

Another member of the ABA task force, Richard Insley of Signet Banks in Washington, claims that "If this is a war on drugs, you never know it by looking at the CID [Criminal Investigative Division]. Local CID agents need manpower and resources desperately, but like good soldiers, they can't buck the chain of command and hang out their dirty linen for the world to see."

The bankers' concerns are echoed by those in the enforcement community who are strapped for resources. Terry Burke of the DEA testified that "the problem has been that * * * the volume of the paperwork is such that at this time that we are virtually receiving no leads from that documentation from those CTR's, because the analysts are overwhelmed with the volume of it." According to Burke, CTR's are primarily used "as a source of information that we go to confirm other information that we have developed from other sources."

Criminals take advantage of the backlog in CTR analysis by actually filing CTR's. According to Terry Burke, in Operation Polarcap, a successful undercover money laundering sting operation, the launderers filed CTR's and bank officials at Wells Fargo Bank only became suspicious when they scrutinized the level of CTR reports and total deposits at each branch and concluded that although the CTR's were all properly filed, the business was not a typical cash-intensive business.

In response to this problem, the subcommittee believes that more manpower and data processing resources should immediately be brought to bear on CTR monitoring and analysis. Both Commissioner Bruh and Secretary Martoche noted that the IRS could use supercomputer capacity with improved software ability.

One area that clearly deserves greater attention is the area of cash transaction reporting by miscellaneous trades and business. Although the Bank Secrecy Act applies only to the range of business defined by the Treasury as financial institution (banks, thrift institutions, securities firms, casinos, and the like) the Money Laundering Control Act, as amended in 1986, requires virtually

every, business in the country—from law firms to car dealers—to report cash transactions over $10,000 to the Internal Revenue Service on Form 8300. Although there have been a few widely publicized attempts to prosecute certain individuals for failure to file, it appears that both public awareness and enforcement of the requirement are extremely spotty.

BANKS AND THE "KNOW YOUR CUSTOMER RULE"

While the CTR process established a paper trail to detect and to deter money laundering, it is not a foolproof system. It is clear that the most effective step a financial institution can take to prevent it from being used by money launderers is the implementation of a strong "know your customer" standard.

Bernard Bailor, chairman of the White Collar Crime Commission of the American Bar Association, in a speech in New York in November 1989, stated that a strict "know your customer" policy serves three purposes: "First, the mere presence of such a policy will frequently deter potential customers who would use the bank for illicit purposes because of their reluctance to reveal information about themselves. Second, the investigation of a potential customer may reveal matters calling into question the bona fides of the potential customer. Third, the investigation of potential customers will give the institution a data base against which the customer's transactions can be evaluated to determine if they are consistent with the customer's legitimate activities."

According to Bailor, there are two distinct parts to a good know-your-customer program: "First, at the time the customer relationship is established, sufficient information should be gathered to enable the institution to make an assessment of the customer's legitimacy. Second, after a customer relationship is established, the customer's accounts should be periodically reviewed to determine if the activity is consistent with the expected normal business activity." As David Wilson of the DEA pointed out, "large sums of cash coming into a bank, no matter what the guise, should tell most bankers that this is an unusual sort of business."

The problem, of course, is that the money launderers have become extremely sophisticated in their techniques and methodologies. Gone are the days when a money launderer entered a bank in south Florida and simply deposited a suitcase of cash. Increasingly the launderers establish front operations that disguise their true purpose. As Terry Burke of the DEA stated, "it is really very difficult for the bank to know its customer that well."

Nonetheless, David Wilson of the DEA believes there are ways to distinguish between the legitimate business and the business created for the sole purpose of laundering cash: "No matter what the trafficker says when it comes to the bank and no matter what business he claims to represent, generally speaking most of these traffickers do not request or require the broad spectrum of banking services. They are looking to deposit cash. They are not depositing checks. They are not requesting lines of credit. They are not doing the sort of routine business that bankers would expect on the scale that the people are handling money."

Donald Reid of Wells Fargo Bank described the kind of "know your customer" procedures that his bank has implemented. Reid

explained, "we use a sliding scale. The more business that a customer does with us, the greater our obligation is to know our customer's source of funds." According to Reid, when reviewing its wire transfer operations, Wells Fargo has attempted to separate its regular account customers from its nonaccount customers: "After the transaction has been completed, the management in our wire transfer operation will screen all the transactions that have occurred twice."

Carl Solberg of Citicorp testified before the subcommittee that banks also need to protect themselves against the anonymous first time depositor or customer. Citibank now prohibits the issuance of U.S. dollar cashier's checks of over $10,000 paid for in cash by a walk-in customer.

These kinds of bank initiatives led Terry Burke of the DEA to comment on the increasing cooperation of the banking community as a whole: "They have become well educated. They have sponsored many of their own programs. They are alert to unusual activity in a given business. If they know their community and with whom they are dealing, then they recognize the signals when there is unusual behavior." This was illustrated in Operation Polarcap where, as Burke testified, "The cooperation we received from the bank, No. 1, initiating the alert to us was a key factor."

Not everyone in the enforcement community believes that banks are doing all that they could. Tim Mahoney of the New York Bank Commissioner's Office testified that "if they're coming in with a large amount of cash, suspicion should be raised. But it hasn't so far to date."

There is, in fact, a great deal more that banks can do to thoroughly know their customer. For example, banks should be required to conduct a full background and credit check for depositors that is similar to the one they conduct for those who wish to borrow money.

Banks could also be required, not just encouraged, to consistently review their exempt lists. There are currently many types of establishments, generally those which generate cash on a regular basis, which are on the Treasury's CTR exempt list which means they are not required to file CTR's. According to the Treasury's published handbook on exemptions, "Treasury recommends that a bank review its exemption list at least once a year, and preferably once every 6 months. In keeping with the general policy that banks should know their customers, each review should include a contact with the customer of each exempted account to determine whether there are any changes in the customer's situation (such as the customer's name, address, or nature of business) since the last date of review. If the bank learns, either directly from the customer or through any other means, that any of the information to which that customer attested on the exemption statement has changed, it should obtain a new exemption statement from that customer that correctly reflects the relevant information from that customer."

Placement on an exempt list should be considered a privilege for both the customer and the bank. Accordingly, there should be penalties for customers which abuse the privilege and there should also be a requirement for banks to certify to the Treasury Department on a yearly basis that their exempt lists are current and jus-

tified. The Treasury Department also should consider appointing teams of IRS agents to conduct spot checks on those businesses which are on the exempt list of any given bank.

The Treasury Department also needs to do additional work with the private banking sector in the adoption of stringent "know your customer" standards abroad. For instance, Carl Solberg, Counsel for Citibank, did not agree with the subcommittee that Citibank should be required to record and to make available records of large transactions over $10,000. He argued that "no citizen, corporate or individual, engaged in legitimate international business should be forced by one government's initiative, however well intentioned, to pursue conduct which is illegal in the country where it takes place." Te subcommittee believes that this kind of attitude must be changed. First, no bank abroad is required to accept a U.S. currency cash deposit over $10,000. Second, banks abroad will have to balance the costs of complying with foreign law that may conflict with tougher American banking standards.

In order to more effectively address these issues Senators Kerry and McConnell sent a letter to Secretary Brady asking him to convene a summit of international bankers during the week of September 25, 1989,while the leading American bankers were gathered in Washington for the World Bank's annual conference. Assistant Secretary Robson wrote back that he did not think that the timing for such a meeting was appropriate. However, Assistant Secretary Martoche, in testimony before the Senate Foreign Relations Committee, generally supported the idea, noting that "it is worth thinking about real seriously. I would want to craft an agenda and set some goals." The Treasury Department should indeed establish an agenda, set goals,and convene a banker's summit. At the top of the agenda should be ways to induce the international banking community to adopt stringent "know your customer" standards.

Civil Liability for Institutions, Officers and Directors

The adoption of the standard of "know your customer," by the Basle Committee on Banking Regulations and Supervisory Practices in December 1988, and thus by the banking community at large, both represents a step toward better compliance by financial institutions in preventing money laundering, and constitutes a benchmark by which the behavior of every financial institution will be measured in those cases in which money laundering does occur.

The subcommittee believes that one significant component of reducing the incidence of money laundering may be an increasing exposure of financial institutions and their officers and directors to criminal and civil liability whenever an institution has been found to have been used to launder money.

Failure of a financial institution to adopt procedures to ensure compliance at the highest level of performance with the Basle Code should provide a factual and legal foundation for civil liability for officers and directors of that institution in any subsequent action for losses in connection with money laundering.

This conclusion becomes clear when one considers the developing case law of corporate criminal liability for money laundering, in

which a financial institution need not even have "known" that the money laundering was taking place, if it failed to adopt procedures designed to prevent it.

In a recent case, the First Circuit found that a financial institution could have corporate criminal liability under the doctrine of "willful blindness" in connection with money laundering. *U.S.* v. *Bank of New England, N.A.*, 821 F.2d 844 (1987). In that case, the First Circuit upheld an instruction from the judge to the jury that a "bank as an institution has certain responsibilities as an organization," and that an "indifference" to the requirements of law was sufficient to prove intent to violate the law.

Thus, criminal liability may be established by the "indifference" standard. Although the Bank of New England case was decided prior to the adoption of the Basle Code, it implies that mere failure to adhere to the standards set for by the Basle Committee could constitute the "indifference" that amounts to "willful blindness" and criminal liability.

Following this reasoning, failure to implement procedures implied as well as spelled out by the Basle Code would itself provide a prima facie case of corporate criminal liability in cases in which money laundering has occurred.

Simultaneously, an institution's officers and directors may face a significant burden in avoiding civil liability for any financial loss, including the cost of defending a money laundering action. in connection with such a prosecution. On the one hand, failure to implement procedures suggested by the Basle Code implies negligence On the other hand, even some form of implementation, if less than the highest standard adopted in the financial industry, could be viewed to be a breach of fiduciary responsibility in those cases in which it does not rise to actual negligence.

The best defense to a civil action against the officers and directors in connection with losses resulting from a money laundering prosecution would be the institution of an aggressive and comprehensive antimoney laundering compliance program which meets or exceeds the highest standards of the industry.

Failure to institute such an antimoney laundering compliance program would be potentially probative in civil litigation against the officers and directors of any financial institution found to have been used to launder money. Liability could extend to legal costs, as well as fines, forfeiture, and lost profits due to the injury to the institution's reputation or operations as a consequence of the original criminal action.

Moreover, civil liability could well extend to cases in which the financial institution is not itself the target of the criminal action, but is found to, No. 1, have been used by a money launderer and is also found; No. 2, not to have taken adequate steps to have prevented that use.

In summary, the developing law regarding corporate criminal and civil liability, taken together with the adoption of the Basle Code by the international banking community, provides a basis for assuming that any financial institution used to launder money, even when it is ignorant of the activity, may be both criminally and civilly liable for that use. Moreover, civil liability would

appear to extend to its officers and directors for any failure to adhere to the strictest interpretation of that code.

Any financial institution in the future which fails to meet the swiftly rising standard of procedures designed to prevent money laundering risks putting itself, and its officers and directors, in a position of unacceptable financial risk.

In the near term, this potentially extensive source of corporate and personal exposure to civil liability may well do more to change past practice by financial institutions and their officers and directors in tolerating money laundering than any particular procedures mandated by the Government itself.

SUSPICIOUS TRANSACTIONS

As a result of provisions contained in the Money Laundering Control Act of 1986, bankers are required to report transactions deemed "suspicious." Earl Hadlow of the American Bankers Association testified that banks are effectively implementing the "suspicious transactions" law, which require "a level of judgment in the bank that is not required with the CTR." He notes, for example, that Barnett Banks, of which he is the president, files 35 to 45 suspicious transaction reports a month.

According to Terry Burke, suspicious transaction reports proved extremely valuable in Operation Polarcap, in which "the DEA, FBI, and IRS were initially notified in the Los Angeles area by a Los Angeles bank of suspicious activity in terms of the amount of money that was being generated by a number of jewelry houses, both wholesale and retail, in the jewelry district in Los Angeles." Despite the increasing awareness and cooperation of the banking community, many suspicious transactions remain unnoticed and unreported.

Part of the problem may be that the banking community is not receiving adequate information and instruction from the Government as to what constitutes a suspicious transaction. As Earl Hadlow of the American Bankers Association testified, "The banking industry has to be educated on exactly what they can do to help in this fight." Hadlow points out that the responsibility for reporting suspicious transactions often falls on "lower level bank employees without a level of judgment, and the volume of transactions is so great that it is a tremendous responsibility."

As it currently stands there is nothing in the law that specifically defines a suspicious transaction. Perhaps the best definition has been set out by Bernard Bailor, chairman of the American Bar Association Committee on White Collar Crime:

> Simply put, a suspicious transaction is a transaction that is inconsistent with a customer's legitimate business activities. Thus, the first key to identifying a suspicious transaction is knowing enough about the customer's business to recognize that a transaction or series of transactions is unusual for a particular customer . . .

The following is a list of potential danger signals:

* Reluctance of the potential customer to furnish references.
* References that cannot be verified.
* Reluctance or refusal of the customer to provide financial statements.
* Reluctance or refusal of the potential customer to disclose other banking relationships.
* Reluctance or refusal of the customer to reveal details concerning business activities.
* Furnishing of unusual or suspect identification documents.

* Customer background not consistent with business activities.

* Business location far removed from banking location.

In order to encourage the reporting of suspicious transactions the Treasury Department should provide a reward to any individual who provides information relating to the arrest and conviction of a money launderer. As Senator Bond noted, "Tellers and bank personnel who go above and beyond the call of duty in looking for and reporting shady dealings should be rewarded."

Current law permits the Secretary of the Treasury to reward anyone who provides information resulting in a fine, penalty, or forfeiture of more than $50,000. The reward equals up to 25 percent of the "net" sum the Government collects up to $150,000. (Title 31, U.S.C., Sec. 5323) However, Congress has not appropriated any funds for the reward program.

Finally, the Internal Revenue Service should explore the possibility of centralizing its investigation of suspicious transactions. Joseph Madison, a banking consultant, testified before the Senate Banking Committee, that in his view "it doesn't seem very efficient to have all the banks in the country write logic for their computer systems to try to detect suspicious transactions." Madison suggests establishing a profile of banks and looking for unusual dollar volumes flowing into and out of those banks. According to Madison, the necessary tools for creating this sort of data base are already at hand: Rand MacNally has a directory that can give us a profile of all the banks in the United States. It has the populations of all the cities herein."

The success of any centralized investigation would obviously depend on the cooperation of and oversight by the Federal Reserve Bank. However, according to the GAO, there is currently no office or individual at each bank specifically responsible for monitoring suspicious behavior relating to money laundering. "Instead," the GAO reports, "various individuals responsible for such areas as bank examinations and criminal referrals look for suspicious behavior as part of their overall duties."

ANTIMONEY LAUNDERING LAW ENFORCEMENT

Coordination and Resources

While much criticism has been leveled at the lack of communication and coordination between the various enforcement agencies in the drug war, examples of the lack of coordination between Federal agencies involved in antimoney laundering enforcement surfaced in testimony before the Foreign Relations Committee. For example, during 1988 the DEA conducted a joint investigation with the Royal Canadian Mounted Police on money laundering in Canada. In September 1988, the two agencies issued a report which concluded that "Canada does not fit the profile of a typical haven nation, yet it has been a repository for drug monies in recent years as a result of certain anomalies in Canadian law." Terry Burke of the DEA did not know if that report had been shared with the Treasury Department. Assistant Secretary of the Treasury Martoche, indicated that he had not seen the report and that it was not shared with his office.

The failure to share this particular information is important because it coincided with debate over the "Kerry amendment" (Section 4702 of the 1988 Omnibus Drug Bill) in the U.S. Senate. The Treasury Department, which opposed the amendment, had argued that it might capriciously alienate allies of the United States. However, the Department failed to mention that the DEA/RMCP report pointed to Canada as a site for substantial money laundering activities in North America.

Another example of a failure of coordination occurred in Operation Greenback, an antilaundering task force located in south Florida that had been highly successful in the early 1980's. Gerald Lewis of the Florida State Comptroller's Office in testimony before the Senate Banking Committee deplored the cutback in Operation Greenback from a high of 77 personnel to only 13. As Lewis put it, "I found this troubling at best at a time when the President has stated in his national drug strategy that money laundering investigations will be expanded and enforcement efforts will be coordinated."

Apparently, however, the cutback reflected less a conscious policy decision than a lack of coordination and breakdown in communications. Senator D'Amato explained to the Banking Committee that the new U.S. attorney in the southern district of Florida was unfamiliar with the situation and withdrew the staff and technical support that his predecessor had provided. The Customs Agency, not wishing to carry the operation alone, in turn, pulled back many of its own resources. According to D'Amato, these mistakes have been recognized and Operation Greenback will once again be fully staffed. Nonetheless, the lack of communication seems inexcusable.

In other investigations, such as Polarcap, coordination has been improved. Terry Burke of the DEA explained the process of intelligence sharing in that successful operation; "* * * we called a meeting at the DEA headquarters in Los Angeles. We brought in IRS, U.S. Customs, FBI, and the Office of the Attorney General in the form of the Narcotics and Dangerous Drugs Section's chief prosecutor * * * We sat down and said this is too big for any one of us to approach as a singular agency in this investigation." Burke explained that "there was total openness and a total understanding that we had to share this information ." As a result of this cooperative approach, the DEA was able to shut down an operation that moved over $1.2 billion through the banking system during an 18-month period.

Still, the Treasury Department has recognized a need for greater coordination in the area of intelligence sharing. The Treasury Department has established an office of Financial Crimes known as FINCEN. In a letter dated July 31, 1989, Secretary Brady wrote to Director of Drug Policy William Bennett that FINCEN will "undertake to gather money laundering information and intelligence from every known source and would provide comprehensive analysis of this 'all source data' in support of narcotics money laundering. By utilizing all available drug and financial information, we will better ensure an inclusive, rather than a fragmented, approach to the multibillion dollar drug problem." Assistant Secretary Martoche stated before the Foreign Relations Committee that "our best hope lies in FINCEN," and the possibilities for artificial intelligence. There will undoubtedly be some overlap between FINCEN and the NADA system developed by the DEA. Nonetheless, Senator Kerry supports the concept of a central clearinghouse devoted only to financial crimes.

President Bush has allocated $15 million for FINCEN. While this represents an expression of commitment, it is clearly insufficient to establish an adequate computer capacity. Terry Burke testified that "we are doing joint planning within the enforcement community to get better computer power for everybody, and I think that is going to be one of the key things * * * the capability of us to meet the challenge in terms of computers in separating this volume of information that we are receiving."

Besides the issue of Federal interagency cooperation on anti-money laundering enforcement and intelligence gathering, there is the issue of cooperation between State agencies and Federal agencies. Regulators from Florida and New York testified on this area before the Senate Banking Committee. Gerald Lewis of the State Comptroller's Office in Florida noted that while cooperation had been non existent in the early 1980's, cooperation at the field level between State and Federal agencies is now "excellent."

However, Lewis went on to describe problems between the State agencies and the Washington bureaucracy. He noted, for example, that the Florida legislature had amended its currency reporting law to allow for the reporting on magnetic tape in order to speed up the process. He testified that his office has been waiting in excess of one year for the IRS to provide them with the correct form in order to properly program their computers. Commenting on the recent creation of FINCEN, Lewis stated, "If their intent is

not to share with states and not to get input from states, then my feeling is they're missing a vital resource."

Another problem appears to be a dearth of human resources. Investigations into violations of the Currency Transactions Reporting Act are, according to Gerald Lewis, of the Florida State corrections office "labor intensive and time consuming" often taking from two to four years to complete. Brian Bruh of the IRS believes that the IRS has sufficient resources and claimed that 450 people are working in the Detroit Data Center processing CTR forms. He also stated that within the criminal investigation unit there are approximately 500 people working in criminal investigations on money laundering. But Terry Burke of the DEA stated "we are certainly going to need increased resources." Chuck Morley was even more definitive: "The government is totally outgunned here."

Related to the problem of human resources is the issue of training. Carl Solberg of Citicorp testified that law enforcement agents working in Operation Polarcap "had not been adequately trained to deal with the sophistication, the speed, the enormity, the complexity, of today's international banking and finance system." Solberg offered the facilities at Citicorp to help train these people. The government should solicit the support of the major banks in training law enforcement agents in anti-money laundering.

Bar Coding

One continuing problem for the law enforcement community is that there is no cost effective method to efficiently track money used in drug transactions as it makes it way through the "laundering cycle." DEA builds many cases through sting operations. However, the manpower required to "mark" bills through the recording of serial numbers has proved an inefficient use of resources and has therefore been largely abandoned by the DEA.

Senators Kerry and McConnell have introduced legislation requiring the appropriate agencies responsible for the production of our paper money to print bills in such a way that the unique serial number on each bill can be identified by an optical scanning device. This can be accomplished through the use of bar codes, digitally read numbers, or magnetic ink. The equipment necessary for implementation of such a plan is currently available as State of the art technology. In fact, Canada already bar codes its currency.

Bar coding currency would allow each piece of paper money to be quickly and easily identified by law enforcement authorities ranging from local police forces to the Department of Justice, the Treasury and the FBI. Barcoding currency could be used to identify money laundering operations as well as counterfeit money.

The Treasury Department has opposed this legislation on the grounds that it may not be technically feasible, might disrupt the U.S. banking system and would only be of marginal value. However, it has come to the attention of the staff of Senator Kerry that in 1988 the Customs Agency was allocated $1 million to buy approximately one dozen high speed serial number readers. Industries from the private sector engaged in this type of technology have unanimously agreed that bar-coding technology is on-line and

substantially more affordable than the serial number reader technology.

Terry Burke of the DEA acknowledged that the barcoding of currency would be useful and that the DEA "would probably be able to develop increased use of it once we get a better computer capacity." Burke explained that the DEA used to track money in the early 1980's by recording the serial numbers of dollar bills, introducing the bills into a drug buy and then after arrest of a drug trafficker, attempting to identify the original bills. Burke described this process as "laborious." As he explained, "We out ran our computer capacity, however. We had to drop that program because of just the volume of serial numbers we were having to generate in our system, it could not handle it."

Senator Kerry believes the Banking Committee should hold hearings on this issue to address the concerns of the Treasury Department.

The BCCI Case

Federal prosecution is one effective way of deterring money laundering, with the potential threat of shutting down any 'financial institution found to have established procedures to facilitate money laundering, or to have permitted its employees to do so.

One of the most clear and egregious cases of a financial institution permitting itself to be used to launder money has been the case of the Bank of Commerce and Credit International (BCCI), which was used by General Manuel Antonio Noriega, as well as a significant number of other narcotics traffickers, to launder the proceeds of criminal activity, including narcotics trafficking.

On January 16, 1990, the Justice Department reached a plea agreement with BCCI, under which the bank pled guilty and paid a forfeiture of $14 million in drug money. In return, the U.S. Attorney prosecuting the case agreed to drop all charges against the bank in connection with any wrongdoing by BCCI known to the United States government. The result was that the bank ended its criminal liability by paying no fine, but merely turning over the proceeds of drug trafficking to the Federal government.

This lenient plea agreement has the possibility of undermining deterrence of other financial institutions from laundering drug money.

In the BCCI case, key officials in the bank appeared to have knowingly and intentionally permitted the bank to launder an enormous amount of drug money. The incidents prosecuted to date represented only a small portion of the cases in which BCCI was reportedly used by criminals to launder illicit funds. These allegations, as yet unprosecuted, would, if proven, demonstrate an extensive pattern or practice of corrupt activities in connection with the bank, extending far beyond the cases prosecuted to date.

According to financial documents maintained on behalf of General Noriega by BCCI, General Noreiga's relationship with the bank was both extensive and intimate. Even after General Noriega was indicted by the United States, the bank continued to move millions of dollars in assets for Noriega from branch to branch beyond U.S. jurisdiction.

For example, on February 12, 1988, the manager of the London Branch of BCCI requested that $14,841,671.47 in one of General Noriega's numbered accounts in London be transferred to the bank's Luxembourg branch, in an obvious attempt by Noriega to provide further protection for the assets from the United States.

On July 26, 1988, BCCI made another series of transfers of money for Noriega. In one transaction, BCCI's Luxembourg branch moved $11,838,866.49 in funds for Noriega to the Banco Nacional de Panama account at the Deutsche Sudamafricanische Bank in Hamburg. In a second transaction, BCCI closed a second account maintained by Noriega at its Luxembourg branch and transferred $3,037,838.48 to the Banco Nacional de Panama account at the Union Banks of Switzerland in Zurich. Presumedly, the U.S. government allowed these transactions to continue because it was implementing the sting, Operation C-Chase.

Indeed, the sting was successful and the U.S. government had a strong case against BCCI. Yet as a result of a plea agreement in which the bank paid no fine, despite its exposure to several million dollars in fines, the Justice Department has essentially reversed basic, sound prosecutorial strategy: the sole remaining defendants in this major money laundering case are individuals. Instead of eliciting information from these officials in order to fully examine the operations, structure and practices of the bank itself, the Justice Department can only probe the behavior and motives of the individuals.

What is perhaps most worrying about the plea bargain is that it includes an agreement that the Government will be prospectively precluded from prosecuting other criminal behavior—it is not possible for the subcommittee to determine what additional information the Department of Justice accumulated concerning the laundering and drug money or the commission of other Federal crimes by BCCI. However, it is clear that the waiver language set forth in the plea agreement constitutes an estoppel constraining the U.S. Attorney in the Middle District of Florida from taking any further actions against BCCI regardless of what additional information concerning criminality involving the bank may develop in connection with the current trial of its officers or in connection with any statements that may be made by the officers after the trial.

The Subcommittee has received allegations concerning possible improper actions by persons associated with the bank that extend beyond the initial indictment. Those allegations include: (a) the bank may have issued false information about shareholders; (b) the bank may not have a lender of last resort; (c) the bank's equity has been offset by loans from the bank to itself; (d) the bank may have made substantial loans to insiders and other shareholders; and (e) the bank may own, control or have a significant interest in various U.S. financial institutions, including the National Bank of Georgia and First American in Washington.

The Subcommittee does not know which, if any, of these allegations could have become the subject of further investigation or prosecution by the Federal government. The plea agreement arguably prevents the Federal government from exploring these significant issues further.

Senator Kerry joined Senator Metzenbaum (D-OH) in asking the judge in the case, the Honorable William Hodges of the U.S. District Court for the Middle District of Florida to take these concerns into consideration in disposition of the plea agreement.

NONBANKING FINANCIAL INSTITUTIONS AND MONEY LAUNDERING

Check cashing stores, money transmitters and money exchanges provide important services to the public, especially to customers who don't have bank accounts or to those individuals who regularly send money to families and relatives abroad. However, these businesses are also being used for nefarious purposes: As Tim Mahoney of the New York State banking Commission noted, "We have seen structured transactions. We have seen money going to the Medellin Cartel."

Mahoney testified before the Banking Committee that money laundering is "going away from the banking institutions and financial institutions" and that increasingly unregulated, unlicensed foreign transmittal agencies are used to launder money. Mahoney estimates that in New York there are approximately 135 illegal operators and that it "is probably just the tip of the iceberg." Unlike banks which are both State and Federally regulated, these services are generally only regulated by the state.

Assistant Secretary Martoche testified that the Treasury Department will increase its efforts to stop money laundering by nonbank financial institutions "now that banks have made the kind of progress they have." Last year, CTR's filed by trades or businesses other than financial institutions numbered only 20,000. The Secretary's comments are timely as the subcommittee hearings have shown that there is a significant problem among foreign transmittal agencies, check cashing stores and money exchange houses.

According to Jerome Gagerman, President of the Check Cashers Association, "Money transmitters are companies that sell or issue instruments used in the transmission or payment of money, including such items as traveler's checks, money orders, wire transfers. Check cashiers act as agents who are authorized by the money transmitter at locations other than an office of the money transmitter." He added that check cashers "draw cash from banks and turn negotiable instruments into cash, not take cash and put it into the banking system."

However, according to Tim Mahoney the operations of these businesses may be somewhat more complex:

> What basically happens is that they advertise in an ethnic type newspaper. They usually put signs on the store fronts that would suggest Western Union. They may even have signs that say New York Banking. They give the appearance of being perfectly legitimate.
>
> The people in the neighborhood utilize them because of the language capability. They feel very comfortable going in there as opposed to a financial institution where they will be charged more money to transmit their funds out of the country.

> Basically, what they do is come in and the legitimate ones who are sending small amounts, maybe $100 or $150, just give the money to the person behind the counter. A small fee will be charged.
>
> The cover they might use [in an illegal operation] might be a travel agency, or a courier service. The bank, if its alert enough, should realize that a travel service basically deals with credit checks from American Express, from Master Card or from Visa; if they're coming in with a large amount of cash, suspicion should be raised.

Gagerman argues that the licensees do thorough background checks of their agents but Mahoney counters that "regulation and supervision of money transmitter agents and sub-agents is at the very heart of the enforcement issue. Licensees can be above board, but what about their agents? What about their sub-agents? Are they reporting all transactions to the licensee? Or are they free-lancing? Until we have the authority to examine their records, we will never know for sure."

Gagerman claimed that while there had been isolated abuses, the industry was by and large efficiently and honestly operated. The Subcommittee believes hearings should examine this problem more closely since as many of 67 check cashing stores across the country are reportedly under indictment for money laundering.

Assistant Secretary Martoche testified that the Internal Revenue Service and the Criminal Investigative Division of the Treasury Department had both targeted the check cashers. Martoche indicated that CID had been investigating on the Texas border "as long as three years ago." Despite these efforts, in some states check cashers are actually exempted from the CTR reporting process. This oversight needs to be addressed.

THE INTERNATIONAL WIRE TRANSFER SYSTEM

Once money has been deposited in the banking system it can be transmitted electronically from bank to bank around the world. According to the Federal Reserve an estimated one trillion (U.S.) dollars in international wire transfers occur each business day. Despite this huge volume of transactions there is important information that can be gleaned from international wire transfers, and the entire system needs to be reevaluated.

In a Banking Committee hearing John Lee of the New York Clearinghouse for International Payments System (CHIPS) explained the evolution and complicated function of the interbank payment system:

> Large dollar wire transfers or, as they are sometimes called, inter-bank payments, can pass either through the Fedwire or thorough the inter-bank payment system. But payment conventions adopted long ago by the world's large banks have put most of the international payments on the CHIPS. Interbank payments evolved after World War II as a means of clearing dollars employed in commercial transactions throughout the world, messages from customers usually made by cable to the New York banks have enabled banks to draw official checks and give them to other New York banks for deposit to the accounts of designated customers.

The privately-owned CHIPS and the Federal Reserve System's Fedwire are formal, regulated payment networks. The instructions to execute payments over these systems come to banks in various ways such as telex, mail, telephone, and most commonly, the worldwide communications system known as SWIFT. SWIFT has a rigid formatting scheme that requires not only debiting and crediting account numbers, but the names of the originator and beneficiary. This format should be adopted by the payment networks. Joseph Madison, a consultant to many large banks, notes that with "CHIPS, the practice certainly is to identify the sending account, the account debited by the sender, by identifier and name. It is not required, however, to identify in all cases the account to be credited by name, the receiving participant."

For example, John Lee of the New York Clearinghouse for International Payments testified that CHIPS has 140 participants and that 83 percent of the Clearinghouse customers have a regular relationship with their banks, but that leaves 17 percent which do not have a regular banking relationship, and therefore need to be closely scrutinized. As Lee explained, "About 17 percent of our transactions every day are what we call unqualified transactions, where there's a piece of it missing." In other words, some information about a transaction, such as the forwarding bank name and the beneficiary account number, is included in a transaction, but the name of the beneficiary or the name of the originator are not

necessarily included as a part of the transaction. Compounding the problem is the fact that there is little or no human oversight of these transactions.

Based on testimony before the Foreign Relations Committee, it appears that U.S. bankers would support tighter control of the international wire transfer process. Don Reid of Wells Fargo Bank acknowledges that the wire transfer system has become "a popular mechanism to move and launder money." In an effort to begin to address this situation, Wells Fargo has established procedures to screen the wire transfers of noncustomers.

Earl Hadlow agrees that the principle problem lays with international wire transfers: "Wire transfers come from foreign banks not with the name of the originating customer on there in most cases * * * it will come from another bank and it will just say, our good customer wants you to transfer $50,000 to your customer. We never know who it comes from * * *"

In an attempt to address this problem the Treasury Department has issued a proposed rulemaking that would require that all domestic wire transfers include certain information. However, foreign banks, which must use the American banking system in order to consummate a wire transfer in dollars, would be excluded from these proposed regulations. Senator Kerry believes that in order for the system to be effective and fair, foreign banks must adhere to the same standard, otherwise the U.S. will be placed at a competitive disadvantage. As Earl Hadlow said, "where the difficulty would arise, all of the European banks and the foreign banks that send money in, it would put an extra step on them. But if they want to continue doing business in the United States, they would have to do that. And without any question, if it was mandated, it would happen."

THE INTERNATIONAL LOOPHOLE

As the United States has imposed a sweeping set of anti-money laundering statutes and regulation covering transactions in this country, criminals have simply moved their money laundering operations offshore where they anonymously deposit the cash in banks and then wire it from shell corporation to shell corporation. David Wilson of the DEA testified that, "We believe that the vast majority of it [money laundering] takes place in a foreign environment. The money may be eventually wired back to the United States: at this point it has been successfully laundered. Earl Hadlow agrees: "The bulk of that money [drug money] * * * is getting into the system in foreign countries, in some unregulated foreign country and then by the time it gets to the United States it is in the form of a very innocent looking wire transfer."

This problem has not been limited to traditional money laundering havens such as Panama, but countries such as England and Canada, both close allies, have been implicated. For instance, CMIR receipts indicate that Canada has repatriated nearly twice as much money to the U.S. as it has received through legitimate sources. As Senator Kerry indicated in the October 4 hearing before the Foreign Relations Committee, "the data show that this year Canadian banks and financial institutions have already sent $4 billion in American currency back into the United States * * * while only $1.2 billion of U.S. currency left the United States in the same period going to Canada."

It seems clear that the United States must seek the cooperation of other countries in order to curtail this growing and serious global problem.

The Subcommittee on Narcotics and Terrorism has been addressing the international loophole for more then two years. The Subcommittee sent a letter to President Reagan in April 1988, requesting that money laundering be placed on the agenda of the June 1988 International Economic Summit Meeting in Toronto and urged the President to seek allied cooperation toward the establishment of an international money laundering control regime.

President Reagan did, in fact, raise the issue during the 1988 Summit and these discussions have continued. As a result of this initiative, the G-7 countries called for a special initiative on narcotics control, and an experts group meeting under U.S. chairmanship in September 1988, recommended initiatives which included: (a) improving cooperation between financial authorities and institutions to curb money laundering and the flow of illicit drug trafficking proceeds; and (b) adoption of measures for identification, tracing, freezing and confiscation of proceeds derived from illicit drug trafficking. All of the G-7 countries have some form of asset forfeiture legislation.

All of the G-10 bank regulatory authorities also supported the adoption of the Banking Committee's statement of principle "for the prevention of the use of banking systems for the purpose of money laundering," which encourages banks to adhere to certain standards, including cooperation with law enforcement authorities, identification of customers, and full compliance with laws on money laundering.

In a report issued to the Banking Committee in November 1989, the Treasury Department outlined other important international efforts. For example, representatives of Interpol (the International Police Agency) recently met in Lyons, France to discuss the establishment of an international clearinghouse for information on money laundering along the lines of that suggested by the subcommittee on Narcotics and Terrorism. These discussions are responsive to the objective set forth in the amendment offered by Senator Kerry, section 4701 of the 1988 Omnibus Drug Bill.

There is no question but that these discussions have helped to sensitize our allies and trading partners to the global dimensions of the money laundering problem and the risks it presents society and legitimate businesses. In the realm of international enforcement, there has been increasing cooperation, with notable results. For example, Congress passed legislation which allowed law enforcement to freeze "commingled" assets and to forfeit "substitute" assets. David Wilson of the DEA noted that this legal theory was particularly useful in both Operation Polar Cap and the Banco Occidente case.

The United States also participated in the drafting of the United Nations Convention against psychotropic drugs and narcotics trafficking. The Vienna Convention eliminates bank secrecy as a grounds for refusing requests for information about narcotics activity. Parties are obligated to take measures making money laundering a criminal offense, and to enact laws for the identification, tracing, seizing and forfeiture of proceeds of narcotics trafficking and money laundering. Parties are also obligated to make money laundering an extraditable offense in existing extradition treaties and to afford the widest possible measure of mutual legal assistance in judicial proceedings. There are currently over 100 signatories to the convention.

Senator Kerry has acknowledged the importance of this treaty and, in fact, shepherded the convention successfully through the Foreign Relations Committee. However, Senator Kerry noted that while the criminalization of money laundering is a step in the right direction, it is "not a sufficient deterrent" to money laundering.

Furthermore, while real progress has been made toward fostering international cooperation in the area of enforcement, there has been precious little movement on the development of a global system of recordkeeping and reporting of large cash deposits. In this regard, the U.S. Treasury does not appear to have undertaken serious bilateral negotiations as required under section 4702 of the 1988 Omnibus Drug Bill. That legislation, known as the Kerry Amendment, requires the Treasury to undertake negotiations with foreign countries over a two year period with the objective of having foreign banks record all U.S. cash deposits over $10,000 and to provide that information in the event of a narcotics related in-

vestigation. Should a foreign bank fail to agree to the limited penetration of bank secrecy, the President has the power to deny that bank access to the U.S. clearinghouse system which is the basis of world trade.

Terry Burke of the DEA in testimony before the Foreign Relations Committee, stated that "there has to be a cohesiveness among the international community and the banking in particular, and of each of these governments in enacting the type of legislation that you have recommended."

In hearings before the Foreign Relations Committee, the Assistant Secretary of the Treasury responsible for the negotiations, Salvatore Martoche, detailed the steps that have been taken so far. He noted that the Treasury, acting through the State Department, sent cables to every diplomatic post, approximately 140 informing them of the Kerry amendment. Subsequently 53 posts were instructed "to approach authoritative host country officials, advise them of the terms of the Kerry amendment, and solicit their views on negotiating a mutually acceptable agreement."

When pressed to provide specifics about the negotiations, the Assistant Secretary acknowledged that he did not have even one full-time staff person assigned to the negotiations. Furthermore, in his November 18 report to the Senate Banking Committee, Secretary Brady indicted that he was only just beginning to assemble a team of negotiators.

The Secretary also declined to identify the countries which have been targeted as "priority countries" for negotiations because the Treasury believes that doing so might jeopardize the sensitive nature of those negotiations. However, based on the testimony of the Assistant Secretary it seems clear that the priorities have not yet been set. Martoche testified that "there has been no formal concurrence with the Justice Department" and that "we have to talk to Mr. Bennett." Martoche added, that within Treasury "we have sort of settled on some [countries] . . ." Senator Kerry believes that the Treasury decision to shroud its analysis and conclusions in secrecy is unfair to U.S. banks operating in those countries who should be placed on notice that they are operating in a money laundering haven.

Even Assistant Secretary Martoche expressed his reservations about Treasury Secretary Brady's decision not to reveal the names of the targeted countries. When asked by Senator Kerry whether or not identification of the countries involved would not "be helpful and salutary to the process of accountability," Martoche agreed, and noted that he does "not make the decisions on what can be disclosed and what cannot be disclosed."

It seems clear that section 4702 is not a priority for the Treasury Department. Martoche expressed concern in the Foreign Relations Committee that the "sovereignty of other countries * * * leads them to resist ideas simply because they have been proffered by the United States." Martoche's concerns over sovereignty extend to the belief that foreign countries might retaliate against the United States and that U.S. banks and businesses might be put at a competitive disadvantage overseas. Martoche cautioned against U.S. unilateral action and compared the United States to the Roman Empire which "thought it would last forever." He argued that com-

peting payment mechanisms would develop and competing clearinghouse equivalent to CHIPS could be developed. Martoche noted that a comparable system has already been developed in Japan.

Even as the Treasury Department delays in its efforts to negotiate money laundering agreements mandated by section 4702, other countries have taken the initiative on their own to implement anti-money laundering legislation. Australia, for instance, has a more stringent and more efficient cash transaction reporting system than does the United States.

The Europeans are also moving quickly to establish new safeguards. They are reportedly concerned with the recent rise in cocaine seizures which indicate a new level of distribution as well as the advent of Europe 1992. As David Wilson of the DEA testified, "we are very much concerned, as are the European countries, about the exact effects that it is going to have on law enforcement being able to track the movement of people from country to country." Italy has implemented legislation requiring recording of cash deposits over a certain limit and Switzerland, still reeling from the "Sharkarchi Affair," in which the Swiss Justice Minister resigned, will debate money laundering legislation in its Parliament early this year.

Senator Pell has invited Secretary Brady to appear before the Foreign Relations Committee to comment on the "Kerry Amendment" negotiations and other important international negotiations on three separate occasions since December 1, 1989. The Secretary, however, has declined to appear himself or to send a high level Treasury official in his stead. The Subcommittee hopes this is not reflective of the seriousness with which he views the issue.

One way in which the cartel launders money in the U.S. is by corrupting banks and bankers. DEA financial expert David Wilson does not believe that the cartels will take the trouble to acquire banking institutions directly. He reasoned that we have already seen cases where certain banking officers in both U.S. and foreign banks have been compromised, and notes that "they [the cartels] really don't need to do that. I think it is probably more of a headache to do that than it is to use the current, existing system." Assistant Secretary Martoche supports this view; "we have discovered that the money launderers have learned that they do not have to buy a bank. All they have to do is buy a banker."

In order to protect against banks being taken over by money launderers, Mr. Serino of the Comptroller of the Currency testified that in 1978 Congress passed the Change of Bank Control Act which for the first time allowed us to prevent people from selling banks to undesirables once they chartered the banks. Serino explained that "we now have an application that is filed with our office for national banks and the other agencies for State ensured banks. We do a background investigation of the people who are acquiring the institution * * * it has been a very good deterrent for people trying to get into the banking business."

Regulatory oversight notwithstanding, it appears that many of the people who bilked the nation's savings and loan institutions during the 1980's were known members of various organized crime families, securities fraud rackets, and white collar criminal organizations. Various reports suggest that these individuals engaged in a systematic effort to obtain large amounts of cash through fraudulent transactions, and then launder their ill-gotten proceeds through banks and shell companies in this country and abroad. According to a Customs report on money laundering techniques, "The troubled Texas banks were highly susceptible to criminal purchase for utilization by criminals who infuse large amounts of cash with no questions asked by bank officials." Neither the Treasury Department, the Customs Agency or the IRS could comment on this statement, or provide any indication that the Treasury Department had developed a strategy to combat this risk.

Yet one merely has to turn to the pages of the currently popular expose of the S&L crisis, Inside Job, to find vivid examples of how real a problem this is. One of the most notable examples involved the 1987 indictment of Sid Shah, a principal of Centennial Saving and Loan, in northern California. When Centennial was closed by Federal regulators in 1985, the bank was insolvent to the tune of $165 million dollars. None of this money has ever been accounted for. Two years later Shah was indicted by a grand jury on charges of involvement in an elaborate $300 million dollar drug money laundering operation.

Money laundering in the S&L crisis was not, however, limited to the proceeds of drug deals. One of the most common forms of fraud involved land flips, where in order to inflate a property's apparent value well above it's actual worth, S&L executives engaged in a number of sham sales of property to inflate it's price. Cases have been reported when bank officers, lawyers, and clerical staff established a cafeteria-line set-up where they would walk the paper down the line to process the loans, sales, and otherwise make it appear that the property had been sold several times a day.

The press is gradually beginning to recognize the role of this kind of organized crime in the crisis, and other independent forms of evidence are being discovered everyday. For example, in mid-December the Government agency responsible for cleaning up the S&L mess, the RTC, announced that the majority of all of the real estate in its portfolio thus far is remote and undevelopable raw land—exactly the same kind of property that was used in such land flips. The common feature of these schemes is that they generate large cash profits with virtually no expense, since no design, engineering, construction, surveying, grading or other land development is involved.

Savings and Loan fraud extended far beyond land flips. For example, Senator Kerry has obtained a copy of a privately distributed handbook on money laundering, tax evasion and bank fraud published by a man reputed to be a former lawyer for the IRS who is now facing charges of mail fraud and wire fraud in northern California. Included in the book, The Transnational Money Game, are various examples of how complex schemes can be employed to launder money, evade income taxes, and profit by fraudulent dealings with "cooperative" financial institutions and savings and loans."

The U.S. General Accounting Office has concluded that fraud accounts for more than one third of all of the losses generated by S&L's. The Subcommittee believes that a large percentage of the money stolen from the S&L's may have been systematically laundered through offshore banking havens, and is now beyond the reach of Federal officials, where it earns interest and serves as a vast "endowment" for organized crime.

Investigative journalists covering the S&L crisis have also stumbled onto a number of links which suggest that the S&L scam artists have laundered their funds and secreted them away in accounts from the Bahamas to Switzerland. For the same reason that international drug money laundering was ignored for so long, international S&L money laundering has been ignored as well: it is extremely complicated, and the fact that the crime occurs in many different jurisdictions, at high speed and under the guise of legitimate business makes it extremely difficult to discern.

Senator Kerry believes that given the enormous sums of taxpayer money that will be required to pay for the savings and loan fiasco, it is imperative that Congress ask what happened to the billions of dollars that have allegedly "vanished." Accordingly, he has requested the Banking Committee to further investigate these important issues.

CONCLUSIONS AND PROPOSED LEGISLATION

After review of the hearing record and evidence assembled as part of the ongoing investigation of money laundering, the subcommittee believes that the following conclusions and recommendations for legislation deserve serious consideration:

1. AGGRESSIVELY PURSUE INTERNATIONAL NEGOTIATIONS BACKED UP BY THE THREAT OF SANCTIONS AGAINST BANKS AND COUNTRIES THAT DO NOT COOPERATE.—In 1988, the subcommittee on Narcotics and Terrorism issued a report which concluded that all too often foreign policy concerns had taken a back seat to narcotics policy and law enforcement. In the case of the Treasury Department, that remains true—the war on drugs is secondary to other global and even domestic financial concerns.

—The United States should work with other nations to eliminate bank secrecy laws. Specifically, the U.S. should negotiate with other countries to require records and reports of cash deposits be made available to the U.S. in the course of a narcotics investigation. If those countries fail to cooperate, the United States should consider either denying the banks of the country in question access to the U.S. dollar clearing system, or revocation of the bank's U.S. charter if it has a branch in the United States.

2. INCREASE HUMAN AND TECHNOLOGY RESOURCES AVAILABLE FOR FINANCIAL ENFORCEMENT EFFORTS.—Money laundering law enforcement may offer the most "bang for the buck" in the war on drugs. At the moment, however, the various Federal agencies responsible for enforcement are being funded at inadequate levels to accomplish the mission.

—More people, particularly trained financial investigators, are needed to analyze the suspicious activity reports and CTR's pouring in from banks. Improved computers, artificial intelligence and on-line telecommunications reporting and database management are needed to make the most effective and timely use of existing information to put money launderers out of business and behind bars.

3. COORDINATE FEDERAL AGENCIES IN MONEY LAUNDERING ENFORCEMENT EFFORTS.—The agencies involved in money laundering law enforcement and intelligence gathering suffer from a lack of coordination.

—Require the Drug Czar to submit a report to Congress on the reorganization of anti-money laundering enforcement and intelligence agencies. Issues addressed should include whether FINCEN should continue to be housed in Treasury or should be made a part of the Justice Department, whether the Secret Service should continue to be responsible for counterfeit and credit card fraud and how Federal-state anti-laundering efforts can be improved.

—The Federal Reserve should provide its data to the IRS which should develop a profile not of customers, but of the banks themselves.

4. REGULATE ON A FEDERAL LEVEL ALL CURRENCY EXCHANGE HOUSES, CHECK CASHING BUSINESSES AND FOREIGN TRANSMITTAL AGENCIES.—Increasingly, money launderers are laundering drug profits through financial institutions such as currency exchange houses and foreign transmittal houses. This represents a gaping hole in our domestic regulatory scheme.

—Require all check cashing, money-order and wire-transfer companies, offices, and agencies to register within thirty days, and again every two years with the Office of Enforcement of the Treasury Department. Such offices must display a Federal sticker or seal in the window of their place of business to indicate compliance. Congress should pass legislation that will make illegal money transmitting a felony and allow Federal law enforcement the ability to review the records of the agents of licensees.

5. AMEND THE CRIMINAL FORFEITURE ACT FOR SEIZED FINANCIAL ASSETS.—Currently all proceeds seized in money laundering enforcement efforts are funneled back to law enforcement. While these agencies deserve the lion's share of the forfeiture proceeds, a portion of the assets should be given to community organizations involved in fighting the war on drugs.

—25 percent of all financial assets seized in money laundering enforcement efforts should be reinvested into high intensity drug zones as defined by the National Director of Drug Policy for anti-drug community-based projects.

6. CONVENE A BANKERS' SUMMIT.—The President and the Treasury Secretary should convene a summit of the Chairman and Presidents of America's money center and super regional banks to enlist top-down support for bank efforts in the war on drugs. President Bush and Secretary Brady held such a White House meeting to enlist support for the Brady LDC debt plan last month during the IMF-World Bank parley. One of the highest items on the agenda should be ways to encourage foreign banks and U.S. banks abroad to keep records of U.S. cash deposits.

7. ENCOURAGE BANKERS TO REPORT SUSPICIOUS TRANSACTIONS.—The government should provide more information as well as follow-up on enforcement efforts to bankers who report suspicious transactions. One important way to encourage greater cooperation is through the existing, but unfunded cash reward system.

—The Treasury should reward those bankers who report suspicious transactions that result in the conviction of a money launderer. A whistle-blower statute should also be considered to protect bank employees who provide information about money laundering on the bank in which they work.

—Provide funding for Title 31, U.S.C sec. 5323—the Treasury reward provision which is to be equal to the lesser of 25 percent of the "net" sum the Government collects or $150,000.

—In order to better elicit the cooperation of the private banking sector, the Treasury should establish a private sector/banking/law enforcement advisory commission. The first priority of that commission should be the establishment of a joint

banking/law enforcement training program. Senator Kerry has introduced legislation along these lines.

8. STANDARDIZE THE CUSTOMER INFORMATION REQUIRED WHEN BANKS EXECUTE INTERNATIONAL WIRE TRANSFERS, REQUIRE BANKS TO MONITOR THESE TRANSACTIONS MORE EFFECTIVELY, AND REQUIRE REPORTS OF SUSPICIOUS WIRE TRANSFER ACTIVITY TO LAW ENFORCEMENT AGENCIES.—The weakest link in the money laundering cycle is the placement stage and this is where law enforcement efforts should be focused. Once money is in the system, it can easily be wired to accounts around the world. Given the volume of international wire transfers, it is impossible to keep track of every transaction. Nonetheless, law enforcement would be greatly aided if certain basic information were required as a part of any transaction.

—The United States should require that any bank wishing to use the international wire transfer systems be required to format both the originator's and the recipient's name and account number.

—Add a business purpose code to the international transaction. This additional piece of information would assist in more fully identifying the parties involved in the transfer and the nature of the transaction.

—Amend Money Laundering Control Act to make it a criminal offense for anyone not registered with the Treasury Department to arrange to transfer, or cause to be transferred, any funds by means of wire transfer or otherwise internationally for any person or company other than themselves. Banks, broker dealers, and thrifts would automatically be deemed eligible.

9. REQUIRE BANKS TO ESTABLISH PROCEDURES WHICH ENSURE THEY KNOW THEIR CUSTOMERS.—Despite the fact that the banking community has by and large been cooperative in specific money laundering enforcement efforts, it is clear that many institutions could be doing more and that certain minimum banking standards need to be established by resolution or by statute. Among the steps to be considered:

—Require banks to conduct a background/credit check for depositors that are doing multiple, large cash volume transactions. These checks should be similar to the those conducted for individuals and businesses who wish to borrow money.

—Amend Bank Secrecy/Money Laundering Control Act to make it a criminal violation for a financial institution to knowingly conduct business with parties using aliases or assumed names.

—Require financial institutions to check the identification of persons opening accounts or otherwise conducting banking business. Commercial customers must present some evidence of the official name of the business, such as incorporation papers, partnership filings, or tax returns.

—Require that checking or NOW accounts be opened in the official name of the business, and the name of the individual or business must appear in print on the front of the check. Also, the "authorized endorsement" of the check must be a real name and signature, not an agreed upon alias, symbol, or mark.

—Amend Bank Secrecy Act/Money Laundering Control Act to require that check cashing, wire transfer, and travel agencies, law firms and accounting agencies not be placed on "exempt lists" for CTR purposes.

10. BARCODE U.S. CURRENCY.—Law enforcement authorities believe that they could more effectively fight the war on drugs if they were able to trace money as it made its way through the banking system.

—Require serial numbers of all newly-issued currency to be readable by optical scanners bar codes. Senators Kerry and McConnell have introduced such legislation.

11. THE BANKING COMMITTEE SHOULD UNDERTAKE A THOROUGH INVESTIGATION OF OFFSHORE MONEY LAUNDERING AS IT RELATED TO THE SAVINGS AND LOAN CRISIS.—There is evidence that much of the money that allegedly vanished in the Savings and Loan fraud was laundered through offshore bank accounts.

—The Justice Department should aggressively seek to uncover the foreign bank accounts of S&L swindlers. The Department should be working with FINCEN to develop a database of all those criminally involved in the Savings and Loan crisis.

—A common scheme employed by money launderers is to establish an offshore account, launder criminal proceeds to that account and then loan the money back interest free. The Congress should reconsider the proposal set forth in a 1984 report issued by Senator Roth's Permanent Subcommittee on Investigations that money borrowed from offshore banks be - considered income for tax purposes unless those banks agree to share information with law enforcement authorities in the course of a criminal investigation.

12. REVOKE THE CHARTER OF ANY BANK WHICH IS CONVICTED OF A TITLE 18 VIOLATION OF THE MONEY LAUNDERING CONTROL ACT.—By forfeiting the Government's right to further prosecute the bank, the Government's plea bargain with the Bank of International Credit and Commerce BCCI, sent the wrong message to corrupt bankers.

—Federal bank regulators should consider revocation of bank's charter whenever there is evidence to suggest that the bank's senior officials or directors had knowledge or participated in money laundering violations to the extent that the operational integrity and viability of the institution is compromised.

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